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International Distribution and Sales Agency Agreements

Andre M. Saltoun

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By ANDRE M. SALTOUN
B.A., University of North Carolina, 1950; J.D., University of Wisconsin, 1960; Partner, Baker & McKenzie, Chicago.

I. INTRODUCTION

The process by which U.S. companies go international is an evolutionary one, starting with scattered export sales to unsolicited foreign customers and ending with, perhaps, the establishment of full-fledged manufacturing subsidiaries worldwide. At some point relatively early in the process, the U.S. manufacturer recognizes that the best way to increase foreign sales abroad without fronting a great deal of capital is to appoint a dealer in the foreign territory. The dealer's function is usually to promote sales of the manufacturer's products in return for compensation that is keyed to the volume of sales.

Since the U.S. manufacturer is usually familiar with the practice of appointing dealers to cover a given territory in the United States, it may not pause to consider that foreign laws regarding the appointment of dealers may have a considerable impact upon the terms of the agreement and its cost to the manufacturer. Yet foreign legislation protecting dealers is growing ever more prevalent and complex, and foreign dealers are becoming increasingly proficient and sophisticated at protecting their interests. Thus, although a dealership contract for use abroad will have essentially the same features as a similar contract for use in the domestic context, it should be adjusted to take into consideration applicable foreign laws and regulations and the international context in which the parties will operate.

* Portions of this outline appeared in Saltoun & Spudis, *International Distribution and Sales Agency Agreements: Practical Guidelines for U.S. Exporters*, 38 BUS. LAW. 883 (1983).

II. TYPES OF AGREEMENTS

One can broadly categorize agreements appointing foreign entities to promote and solicit sales of certain products as either of two types (or a hybrid of the two):

A. **Distribution Agreement**

A distributor:
1. buys and sells for its own account;
2. bears the economic risk of sales (*e.g.*, carries customers' credit);
3. warehouses and physically distributes goods; and
4. is an independent entity which cannot act on behalf of the supplier.

B. **Sales Representative Agreement**

A sales representative:
1. does not buy or sell for its own account but is compensated by commission;
2. bears no risk of customers' nonpayment;
3. takes orders for shipment direct to the customer from the supplier; and
4. may not bind or act on behalf of the supplier without express or implied authority.

C. **Variations**

Of course, these are very generalized rules, and in any given situation an agreement may have characteristics of both a distribution agreement and a sales representative agreement. In certain jurisdictions both distributors and sales representatives may be treated similarly so that an identification of the type of agreement is irrelevant. If types of dealers are distinguished under a foreign law it is almost always by the same criteria: amount of authority and independence (including economic independence) from the supplier. ("Distributors" and "sales representatives" will be referred to collectively as "dealers" herein.)

III. FOREIGN LEGISLATION

Although in most foreign countries the general law of contracts is applied to dealership agreements, legislation or judicially-developed doctrines exist in certain jurisdictions which restrict the freedom of contract in the dealership area. Thus, the parties' agreement as to the duration of the contract, what shall constitute a breach and what acts shall terminate the agreement without payment of termination compensation, may be overridden by foreign law.

A. Background

1. History of Abuse by Suppliers

Current legislation protecting dealers was prompted by a perception that suppliers were taking advantage of local dealers. It is true that in the past some suppliers employed local dealers to develop local goodwill and clientele and then, when the foothold in the market was strong enough and the return on the investment of the dealers was in sight, the suppliers would terminate the dealers and substitute the former dealers with local affiliates or subsidiaries of the suppliers, thereby taking a direct profit. To be fair, however, it should be noted that the suppliers were not always the abusing parties; sometimes the dealers did not try to build up the market but instead attempted to derive maximum short-run profits.

2. Lack of Bargaining Power of Dealers

In addition, foreign jurisdictions often feel that the average local dealer, usually a small businessperson, has no bargaining power in dealing with large manufacturers.

3. Ownership Interests

Foreign jurisdictions often find that the dealer has an ownership interest in clients and goodwill which the dealer develops. Thus, the dealer is to be compensated when the supplier appropriates to itself the clients and goodwill at the termination of the dealership contract.

B. Current Situation

For these reasons, the number of countries which have enacted special restrictive legislation or developed similar judicial doctrines in the dealership area has dramatically increased in the last decade. The prototype of such dealer legislation was enacted in Puerto Rico in 1964. Similar restrictions exist today in approximately 45 countries.[1] It might also be noted that similar pressures have been placed on state legislatures in the United States to enact protective dealer legislation, usually in relation to dealers in specific products such as automobiles. Wisconsin has enacted comprehensive legislation applicable to dealers in all types of goods.

C. Types of Foreign Legislation

Foreign legislation applied to dealership agreements falls into three primary categories:

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1. *See* Appendix, *infra*.

1. Legislation Enacted Specifically to Protect Dealers

   This type of legislation typically has the following features:

   a. *No Termination Without Compensation*

      The most typical feature of dealer legislation is the requirement that substantial compensation be paid to the dealer upon termination. Certain jurisdictions require that termination compensation be paid if there is no satisfactory reason for the termination.

      Example: The best example of this type of legislation may be Puerto Rico's prototypical legislation. The Puerto Rican law requires that even though the dealer's contract gives the supplier the unilateral right to terminate the agreement at any time, no supplier may terminate the contract or even refuse to renew a contract that has expired, except for "just cause."

   b. *Just Cause for Termination Needed*

      Frequently the only termination that may occur without payment of compensation is termination with "just cause." Just cause is typically defined to include the nonperformance of any essential obligations of the dealer, or acts or omissions that adversely and substantially alter the supplier's interests.

   c. *Distinction Between Definite and Indefinite Term Agreements*

      The legislation will often have a greater impact on agreements which are open-ended than on agreements which are for a fixed number of years. With some exceptions, such as the laws of Puerto Rico and a few Latin American countries, an agreement with a fixed duration may be allowed to expire without payment of compensation to the dealer, provided no promise of renewal was given. There is, however, a strong risk that agreements which are silent as to the term or which provide for automatic renewals may be considered indefinite term agreements. In such a case legislation will frequently require that termination compensation be paid.

   d. *Notice*

      Adequate notice of termination may be required. The definition of adequate notice varies but it usually requires a relatively long time in comparison to the fast pace at which today's international company would like to move. Also, notice requirements may vary according to the length of time the agreement has been in existence at the time of termination; the longer the agreement has been in existence, the longer the time of notice should be. In some countries notice may not be required if just cause for termination exists.

e. *Compensation*

The compensation which the foreign legislation may require to be paid is, of course, the U.S. supplier's primary concern because the amounts involved can be quite high. Compensation is usually based on the following factors:

1) Lost profits, which in turn may be based on:
   i) average profits of the dealer;
   ii) length of service;
   iii) amount usually earned by the dealer in a length of time equal to the statutorily required notice period; or
   iv) length of the unexpired term of the contract;
2) goodwill generated by the dealer;
3) expenditures made by the dealer to develop the market; and
4) labor and warehousing costs which cannot be recouped (redundancy costs).

Repurchase of goods from the dealer may also be required. Total compensation may equal three to five years' average profits for the dealer.

f. *Forced Settlement*

Even in those countries where the possible compensation awards are not too high there may be other problems with termination. For example, the dealer can force the supplier into a high settlement by:

1) obtaining an injunction against termination pending settlement;
2) blocking registration of a new dealer with the appropriate authorities until the supplier has settled with the old dealer; or
3) enjoining entry of goods into the country until settlement.

g. *Waivers Ineffective*

The obvious method of avoiding the application of this legislation would be to have the dealer waive its application at the time of execution of the contract. Waivers, however, are usually ineffective because a public policy decision has been made by the legislature to protect the dealer who is perceived as naive or without bargaining power.

h. *Contrast with Common-Law Jurisdictions*

The legislation described above is markedly different from our common-law rule that the parties may negotiate their own contract and set whatever conditions for termination they desire. For example, the parties can set minimum sales quotas which, if not met by the dealer, may constitute breach and grounds for termination. As one court noted, this dealer legislation is like a conversion of all temporary liaisons into marriage, with, as a consequence, the requirement of divorce and alimony.[2]

2. Application of Local Labor Laws

In addition to legislation enacted specifically to protect dealers, labor laws enacted to protect employees in general may also be applied to dealers. Such laws could require the payment of severance pay and, in certain cases, disability compensation and social security.

a. *Applied to Individual Dealers, Commission Agents*

Labor laws should only be applicable when the dealer is an individual rather than a legal entity. Also, they are more likely to apply to commission agents than to distributors since a distributorship is generally considered to be more of an arm's length arrangement.

b. *Factors in Applying Local Labor Laws*

In deciding whether the dealer should be deemed to be an employee of the supplier the following factors will be considered:

1) the amount of control the supplier exercises over the dealer;
2) the amount of the dealer's time spent servicing the supplier;
3) the source of capital supporting the dealership;
4) the method of compensating the dealer (salary, commission or discount);
5) the location of passage of title to the merchandise; and

2. Fornaris v. Ridge Tool Co., 423 F.2d 563, 568 n.9 (1st Cir. 1970), *rev'd on other grounds*, 400 U.S. 41 (1970).

6) the name under which the operations are conducted.

3. Prohibitions on Use of Distributor or Agent

A third type of legislation restricting the supplier's freedom of contract with dealers is legislation which prohibits or restricts the appointment of dealers. This legislation is enacted not so much to protect the dealer but rather to protect the public from unscrupulous or costly middlepeople. Such laws may take the following forms:

a. a prohibition of the use of dealers generally (Algeria);
b. a prohibition of the use of dealers in connection with sales to some or all government agencies;
c. a prohibition of the use of nonnationals as dealers (Iraq, Egypt, Jordan, Kuwait, Libya, Saudi Arabia, and Burma);
d. a requirement that dealers register with a government agency and disclose their agreements (Saudi Arabia, Abu Dhabi, Panama);
e. a requirement that the manufacturer have a direct relationship with the dealer or that there be no more than one middleperson between the manufacturer and the consumer.

D. Guidelines for Minimizing the Adverse Effect of Foreign Dealer Legislation

Over the years attorneys for exporting companies have developed and employed various measures to minimize the adverse effects of this foreign legislation. It should be stressed, however, that the most effective means of avoiding application of the legislation is the choice of a satisfactory dealer at the outset, for if the dealer's performance is good, termination issues may never arise.

1. Principal-to-Principal Relationship

Foreign dealer legislation is more often drafted to protect sales representatives or commission agents rather than distributors. Thus, in most cases, the appointment of a distributor will be preferred. If a sales representative is to be appointed, the relationship should have as many indicia of an independent contractor, principal-to-principal relationship as possible. It is therefore important that the sales representative not be the supplier's legal agent in the territory and not have the power or capacity to bind the supplier or to act for, or on behalf of, the supplier. A statement to this effect should be included in the agreement.

2. Appointment of Legal Entity
   If at all possible, legal entities should be appointed as dealers rather than individuals in order to avoid the application of local labor laws. If an individual is appointed, then the appearance of an employer-employee relationship should be avoided by paying a commission rather than a salary, not setting working hours and having the dealer work for other suppliers.
3. Term
   In general, the contract should provide for a fixed, definite and relatively short term. Termination of indefinite term contracts may not be permitted without payment of compensation, but a definite term contract can usually be allowed to expire without renewal.
4. Renewals
   Successive renewals can cause definite term agreements to be interpreted as having an indefinite term. Thus, if renewals are to be mentioned in the agreement, only one renewal term should be provided for. If at the end of the renewal period the parties do not want to let the contract expire, a new contract could be executed. Multiple contracts between the same parties, even with amended terms, however, may have the same effect as successive renewals in certain jurisdictions.
5. Grounds for Termination
   a. *Just Cause*
      The local law's definition of just cause should be checked. At least those events specified by law should be listed in the agreement as grounds for termination.
   b. *How Specific?*
      Note, however, that there is a debate as to whether specifying such events limits one to termination for those events only (*expressio unius est exclusio alterius*). A consensus seems to be emerging that it is generally safer to carefully specify the events constituting just cause, since listing them is helpful in defending termination.
   c. *On Passage of Law*
      In addition to the usual grounds for termination, a clause is sometimes included in dealership agreements which provides for automatic termination effective the day before any bill is either introduced or passed in the legislature of the territory which would grant dealers

extracontractual rights upon termination or nonrenewal of their contracts. This provision is of doubtful enforceability but it is not harmful and may have a chilling effect upon suit by the dealer.

d. *Performance Criteria*
Since making sales is usually the dealer's most important function, if negotiable, the contract should specify minimum sales quotas for the dealer. If the quotas are reasonable failure to reach these sales quotas may be just cause for termination.

6. Cure Period
Offering an opportunity to cure is usually helpful in defending against claims of unjust termination. In certain instances a cure period is not warranted, however, and automatic termination might be provided for. Examples of this latter situation include dealer's bankruptcy, change in ownership of dealer, nationalization of dealer or duration of a *force majeure* situation for longer than a specified time.

7. Notice of Termination
It should be determined whether local law requires or suggests the amount of notice of termination or nonrenewal which the dealer should receive. As a general rule, if there is no dealer legislation, one should give three months' notice of termination. Where dealer legislation exists, consideration should be given to providing for four to six months' notice, depending upon the length of the relationship. For certain jurisdictions, such as Belgium, it is important that notice be sent by registered airmail, return receipt requested.

8. Waivers of Compensation
Although waivers are of doubtful enforceability in the face of dealer legislation, a waiver of compensation should be included as it may at least have a chilling effect on suits for compensation. The waiver should include the following elements:
   a. waiver of termination compensation and consequential damages;
   b. indemnification of the supplier for claims of employees or subrepresentatives of the dealer;
   c. waiver of the right, without the supplier's permission, to register as the supplier's agent or distributor in any other country or territory.

9. Supplier's Retention of Rights

   The supplier might retain the following rights, if negotiated for:

   a. right to appoint additional dealers;
   b. right to make sales directly to customers in the territory (or at least to government entities in the territory);
   c. right to approve major investments (but note the risk that retention of this right bolsters the employee-employer argument. It also may cause the supplier to be liable for reimbursement of expenses upon termination).

10. Dispute Resolution Provisions

    Perhaps the most effective means of avoiding the payment of special termination compensation is to provide for arbitration and choice of law outside the dealer's jurisdiction.

    a. *Arbitration*

       Many consider arbitration to be a more satisfactory method of dispute resolution than resort to foreign courts which may involve delay and expense.

       1) Rules: American Arbitration Association (A.A.A.), International Chamber of Commerce, or UNCITRAL rules could be specified, but A.A.A. rules may be preferable to the U.S. exporter.
       2) Arbitration posture: If the U.S. supplier expects to be on the defensive when, for example, a sales representative sues for commission or compensation, it is best to provide for an arbitration site in the United States since this will help to prevent suit. Also, if the dealer ignores the arbitration provision and brings suit in its local courts, the U.S. courts may not enforce a default judgment obtained against the supplier. If the supplier expects to be on the offensive, then a foreign arbitration site may not be objectionable because the U.S. supplier would probably have to bring suit in the foreign country anyway in order to enforce an arbitral award.

    b. *Choice of Law*

       It is generally in the supplier's favor to stipulate that the law of the suppliers jurisdiction will govern. In certain countries this choice of law may avoid the application of local dealer protection legislation (*e.g.*, West Germany).

11. Duties of Dealer

In general, the more specific the listing of the dealer's functions the better, as this will lessen the chance of a misunderstanding between the parties. It is especially important to specify the dealer's responsibilities as to installation, service or warranty activities and how the dealer will be compensated for these services. Certain countries require that after sales service of products be guaranteed to the consumer by a local entity.

E. **Other Measures to Protect the Supplier's Interests**

1. Terms of Sale

a. *Distributors*

Since distributors actually buy the goods from the supplier, the terms of sale should be fixed by the contract (either in the text or by reference to the supplier's standard terms). Price, credit, currency, means of payment and shipment terms should all be specified.

b. *Sales Representatives*

Since sales representatives do not buy the goods but only take orders, terms of sale are inappropriate in the contract of appointment. The supplier may wish, however, to append the terms of sale to the agreement as an exhibit and to specify that the representative will solicit sales only in accordance with the supplier's terms, as modified from time to time.

c. *Warranties*

Applicable warranties should be included in the contract which appoints a distributor. The obligation should also be placed on the distributor to inspect the goods for defects within a certain time period. Although this is not necessary for the sales representative agreement, the supplier should obtain from every dealer an agreement to make no additional warranties on behalf of the supplier.

2. Trademarks, Tradenames and Confidentiality

The following standard intellectual property clauses may serve to protect the supplier's interest.

a. *Clauses*

1) Dealer's acknowledgement of supplier's ownership of all right, title and interest in any trademarks or tradenames to be used and of the fact that it will acquire no such interest by virtue of its activities.

2) Restrictions on dealer's right to use supplier's trademarks and tradenames only to promote and solicit sales of the products.
3) Prohibition against dealers adopting or using the trademarks or tradenames or any confusingly similar word or symbol as part of its company name.
4) Reservation by the supplier of the right to bring an infringement suit.
5) Agreement of dealer to report all infringements to supplier and to assist supplier in prosecution.
6) Prohibition of distributors altering or defacing product packaging or marks. (Sales representatives will theoretically never handle products).

b. *Local Registration*

In certain foreign countries the mere use of the trademark by the dealer in connection with sales and promotion may require that the agreement be registered with local administrative authorities. Therefore, prior to granting the right of use, the local law should be checked.

c. *Confidentiality*

The dealer's obligation not to disclose confidential information can be extremely important, especially for dealers in computers and computer software protected by trade secret rights alone. Therefore this clause should be broadly drafted and contain some discussion of conditions under which the dealer's employees will receive the information.

d. *Liquidated Damages*

Certain jurisdictions require that damages be proven in a sum certain and yet recognize liquidated damages or penalty clauses. Since the damages from a breach of a confidentiality or trademark clause are difficult to prove, the parties should agree upon a fixed sum to be paid as a penalty for violation of such a clause, especially where there is a chance that the local law will recognize such a clause. Moreover, such a clause may have a deterrent effect.

3. Compensation

a. *Commissions*

The volume of sales on which the commission is based should be determined. Discounts, shipping and taxes should be excluded. The time period over which total sales are to be calculated should be specified. Whether a commission will be paid on all sales in the territory, even those made without the dealer's promotion, should be decided. Whether the commission will be on amounts invoiced or amounts received should also be decided.

b. *Method of Payment*

To comply with local exchange control regulations and income tax laws applicable in the dealer's country, the best method of payment is by check or wire to a bank within the territory. A dealer's suggestion that it be paid in a third country may raise questions regarding corrupt practices by the dealer. If the currency of payment for the goods is different than the currency in which the commission is to be paid, a currency translation mechanism should be specified.

IV. OTHER RELEVANT LAWS

Although not enacted with the specific intent to affect dealership agreements, the following laws may apply to such agreements.

A. **Exchange Control Laws**

Local exchange control regulations frequently require that nationals repatriate all income received from services performed within the country. Requests to receive payment outside the dealer's territory should be interpreted as an attempt to avoid these regulations. The U.S. supplier may actually be criminally liable for aiding and abetting or, in certain instances, for directly committing violations of these regulations (and possibly local income tax laws as well) if it sends payment to a third country.

B. **Competition Rules**

1. United States

a. *Exclusivity* (An arrangement whereby the supplier agrees not to appoint other dealers in the territory)

This is not a problem under current U.S. antitrust law. The threshold question here is whether the undertaking with regard to a foreign dealer has an impact on U.S. commerce. The Justice Department considers territorial exclusivity to be a feature of a customer-supplier relationship which, taken alone, would have no impact on U.S. commerce.

1) Network of Foreign Dealers

A network of foreign dealers, dividing the world into territories, should be permissible on the same basis.

2) Network Enforced by Restraints on Export Sales
Imposing restraints on the U.S. exporter's domestic distributors in order to enforce its network system may raise Sherman Act questions. A "rule of reason" should be applied allowing the supplier to justify the restraints as necessary for gaining a foothold in the market, preserving goodwill or maintaining quality control.
3) Appointment of Competing Manufacturer as Dealer
Such an arrangement may be perceived as an agreement not to compete. The Justice Department, however, will allow this if it is of short duration and is necessary to establish a foothold in the market.

b. *Noncompetition* (An arrangement whereby the dealer will not handle competitive goods)
A possible Sherman Act violation exists if the given dealer is absolutely necessary in order to make sales in that territory. For example, if the given dealer is the only one technologically capable of dealing in the goods, noncompetition clauses would affect U.S. commerce because they would foreclose opportunities to other U.S. exporters. Factors in finding a violation include:
1) Degree of market foreclosure caused by the restriction. (Note that some would argue that if the product is so weak that it can be foreclosed by one exclusive dealership, then the actual sales foreclosed will be too minimal for concern. In that case perhaps the dollar amount of sales foreclosed and not the percentage of the market foreclosed should be examined.)
2) Impossibility, commercial or legal, preventing the dealer from handling competing goods anyway.
3) Availability of a less restrictive alternative.
4) Business reason for the restriction. For example, the supplier is so distant from and unfamiliar with the market that it can only be reassured by a total commitment from the foreign dealer.
5) Duration. This is important as an indication of reasonableness.

c. *Tie-Ins and Prohibitions on Resale to the United States*
Analysis is the same as with noncompetition, and the same factors as above will apply.

d. *Resale Price Maintenance*
Such restrictions are unlikely to affect U.S. commerce but must be examined under foreign law.

2. Foreign Competition Rules
a. *European Economic Community (EEC)*
The EEC has very developed competition rules stemming from Article 85 of the Treaty of Rome, Mar. 25, 1957, 298 U.N.T.S. 11, which prohibits practices and agreements that restrict or distort competition within the EEC or between member states. The EEC Commission will apply Article 85 to parties outside the EEC if there is sufficient effect within the EEC.
1) "De Minimis" Exception
Currently, the effect of an agreement may be considered to be negligible if:
i) the contract goods do not represent more than 5% of the total market for such goods in a substantial part of the EEC; and
ii) the aggregate annual sales of the parties (including both parent and subsidiary companies of the supplier and distributor) do not exceed 50 million ECU's (approximately $50 million in U.S. currency).
2) Block Exemptions
The EEC Commission has promulgated regulations under authority of Article 85(3) of the Treaty of Rome granting automatic exemptions to all exclusive distribution and exclusive purchasing agreements containing only certain specified restrictions.[3] The block exemption for distribution agreements was originally available under EEC Commission Regulation 67/67.[4] On July 1, 1983, Regulation 67/67 was replaced by two regulations: 1983/83 regarding exclusive distribution agreements and 1984/83 regarding exclusive purchasing agreements.[5] Agreements in force prior to December 31, 1983, which conformed to Regulation 67/67 are allowed until

3. *See* B-II ENCYCLOPEDIA OF EUROPEAN COMMUNITY LAW 10,070 (1983).
4. 10 O.J. COMM. EUR. (No. L 57) 849 (1967).
5. 26 O.J. COMM. EUR. (No. L 173) 1, 5 (1983).

December 31, 1986, to be modified in accordance with the new regulations.

i) Exclusive Distribution Agreements

The following restrictions may be included in exclusive distribution agreements under the new Regulation 1983/83 without jeopardizing the availability of exemption from the application of Article 85:

a) Noncompetition Clauses

The distributor may be prohibited from manufacturing or distributing products which compete with the contract products during the term of the contract.

b) Exclusive Purchasing

The exclusive distributor may be required to obtain the goods only from the other party (*i.e.*, from the supplier as opposed to parallel distributors or other third parties).

c) Export Sales

The distributor may be prohibited from soliciting customers outside its territory and from maintaining a branch or warehouse outside its territory. Note that it is not permissible, however, to prohibit the distributor from *selling* outside its territory; *i.e.*, the distributor must be permitted to make unsolicited export sales.

d) Direct Sales

The *supplier* may be prohibited from supplying the goods to users in the territory.

e) Minimum Purchases

The distributor may be required to purchase a full line of the products or to purchase minimum quantities of the products.

f) Trademarks

The distributor may be required to sell the products under trademarks or packed and presented as specified by the supplier.

g) After Sales Service

The distributor may be required to provide customer (after sales) service and guarantee or warranty service.

h) Promotion
The distributor may be required, in order to promote sales:
—to advertise the products;
—to maintain a sales network for the products;
—to maintain a stock of products;
—to employ staff having specialized or technical training for the products.

i) Territory
The distributor's territory may now be restricted to the *entire* EEC instead of merely a *part* of or a member state within the EEC.

ii) Regulation 1983/83
The block exemption will not be available to exclusive distribution agreements which contain the following restrictions:

a) Reciprocal Agreements Between Manufacturers
Under Regulation 1983/83 manufacturers of competing goods may not enter into reciprocal exclusive distribution agreements for those goods without losing block exemption protection.

b) Restraints on Intrabrand Competition
The block exemption is not available if the parties take measures to restrict the availability of the contract goods to either dealers or consumers. Such restrictions may be found either in the text of the agreement or in the manner of implementation of the agreement.

c) Restrictions on Availability to Consumers
The block exemption will not be available if, notwithstanding the provisions contained in the text of the agreement, consumers of the contract goods can, as a practical matter, only obtain the goods from the exclusive distributor and have no alternate source of supply outside the territory. This would be the case where the

supplier is enforcing a policy of absolute territorialism; that is, the supplier places an export prohibition on all of the distributors in its network of suppliers.

iii) Exclusive Purchasing Agreements

The EEC Commission considers an exclusive purchasing agreement to be one under which a distributor undertakes to purchase certain goods for resale only from a given supplier without obtaining from the supplier a grant of exclusivity with regard to a specific territory in return. Thus, if a distributor is to be a *nonexclusive* distributor, the availability of a block exemption (and the permissibility of an exclusive purchasing requirement) is governed by Regulation 1984/83. If the distributor is to be *exclusive*, and yet the goods are to be purchased only from the supplier, Regulation 1983/83 governs. Regulation 1984/83 is concerned with resale; it does not apply to "requirements contracts," *i.e.*, exclusive purchasing for end use. The following restrictions may be included in exclusive purchasing agreements without jeopardizing the availability of the block exemption under Regulation 1984/83:

a) Exclusive Purchasing

The purchaser may be required to purchase the goods for resale only from the supplier or from one of the supplier's affiliates or distributors.

b) Minimum Purchases

The purchaser may be required to purchase minimum quantities of goods.

c) Trademark

The purchaser may be required to sell the products under trademarks.

d) Sales Promotion

The purchaser may be required in order to promote sales:

—to advertise the products;

—to maintain a sales network for the products;

—to provide the customer with after sales and guarantee service; and

—to employ staff having specialized or technical training for the products.

e) Supplier's Direct Sales

The supplier may be prohibited from directly selling the goods in the purchaser's "principal sales area" and at the purchaser's level of distribution.

A block exemption under Regulation 1984/83 will not be available to exclusive purchasing agreements which contain the following restrictions:

a) Export Sales

In contrast to Regulation 1983/83, the purchaser in an exclusive purchasing agreement may not be prohibited from soliciting or effecting export sales or from establishing a distribution network throughout the EEC.

b) Reciprocal Agreements Between Manufacturers

The block exemption is unavailable to exclusive purchasing agreements between manufacturers.

c) Products

The exemption is not available to exclusive purchasing agreements which cover more than one type of goods unless the goods are connected by their nature or commercial usage.

d) Duration

In contrast to exclusive distribution agreements, an exclusive purchasing agreement will not be eligible for the block exemption if it has a fixed term of longer than five years.

3) Sales Representatives and Commission Agents

In the past Article 85 has been directed solely at distribution agreements. Contracts with sales representatives or commission agents have been exempted on the basis that the principal-agent relationship is essentially one of employment in which restrictions are to be expected.[6]

b. *Other Foreign Competition Rules*

The most developed national competition laws having application to dealership contracts are found in Canada, France, Germany, the United Kingdom, Japan and Australia. These laws should be checked before entering into agreements for use in these countries.

3. Drafting the Dealership Agreement in Light of Applicable Competition Rules

In order to make sure that an overseas distribution arrangement is permissible under both U.S. and foreign competition rules, points concerning territory, the nature, modification and future development of products, the dealers' exclusivity and the supplier's right to make direct sales into the territory should be carefully and explicitly resolved. If there are business justifications for restraints they should be set out in the agreement.

C. **United States Antiboycott Laws**

In response to the Arab boycott of Israel, the United States has enacted two separate legislative and regulatory schemes which restrict the extent to which U.S. persons and firms may agree to comply with Arab boycott requirements, such as requests for information or certifications in connection with letters of credit.[7]

1. If Supplier Has Ownership Interest in Dealer

a. *Export Administration Act*

The prohibition of the Export Administration Act extends to actions taken by "United States persons" with respect to activities in interstate or foreign commerce of the United States and with the intent to comply with, further or support any boycott against a third country friendly to the United States.

A "United States person" is defined as any U.S. resident or national (other than an individual resident outside of the United States employed by other than a U.S. person), any domestic concern and any foreign affiliate of a domestic concern which is controlled in fact by such domestic concern. 15 C.F.R. § 369.1(b) (1983). A foreign affiliate will be presumed to be "controlled in fact" if the domestic

6. *See* Notice on Exclusive Agency Contracts, 5 O.J. COMM. EUR. 2921 (1962).

7. *See* Export Administration Act, 50 U.S.C. App. § 2407 (Supp. 1983); 15 C.F.R. §§ 369.1-.8 (1984); I.R.C. §§ 908, 952(a), 995(b)(1)(F), 999.

concern beneficially owns or controls (directly or indirectly) 25% or more of the voting securities of the foreign entity and if no other person owns or controls (directly or indirectly) an equal or larger percentage. 15 C.F.R. § 369.1(c)(2) (ii) (1983).

b. *Internal Revenue Code*

1) The sanctions for boycott participation can involve the loss of several valuable tax benefits:

i) loss of benefit of tax deferrals from Domestic International Sales Corporations (DISCs) and in the future, of tax exemptions from Foreign Sales Corporations (FSCs) pursuant to application of I.R.C. § 995(b)(1)(F) and § 927(e)(3), respectively;

ii) loss of I.R.C. § 901 foreign tax credits on boycott-tainted transactions under I.R.C. § 908;

iii) if a U.S. shareholder owns 10% or more of stock in a foreign corporation, loss of foreign tax credit on dividends paid by the foreign corporation out of boycott income;

If a U.S. shareholder owns 10% or more of the stock of a foreign corporation and if the corporation is more than 50% owned by U.S. shareholders, domestic shareholders will be required to include boycott income of the controlled foreign corporation directly in their income, without benefit of the foreign tax credit.

2) Moreover, the Code requires that each taxpayer report operations in or related to boycotting countries. This reporting requirement extends to affiliates of which the taxpayer owns 10% or more. Thus, if the supplier has an ownership interest in the dealer, actions by the dealer may have antiboycott law implications for the supplier.

2. Dealer is Independent

There is also a risk of liability even if the dealer is independent if it supplies prohibited information on behalf of or at the direction of the U.S. exporter.

3. Clauses in Contract

United States exporters appointing dealers in the Middle East should provide in the appointment contract that:

a. the dealer is an independent contractor and has no authority to act on behalf of the supplier; and

b. the dealer is prohibited from supplying any boycott-related information regarding the supplier.

D. United States Export Control Regulations

These regulations restrict the export of goods from the United States for national security purposes, to further foreign policy commitments of the United States and to protect the supply of scarce goods.

Goods which do not need to be restricted for these reasons may be exported under a general license (for which no application is required and no document is issued). In contrast, a validated license, requiring review by the Office of Export Administration, is required for every shipment of controlled goods to some or all destinations. In support of every application for a validated export license or reexport authorization, the supplier may be required to submit a statement by its distributor regarding the distributor's responsibility for the ultimate disposition of the goods.

1. Distribution License

The validated license process is time consuming and costly. If an exporter has a foreign distributor, it may be able to shorten the process by applying for a special distribution license which eliminates the need to make repeated applications. Such licenses are available where 25 or more individual validated licenses would otherwise be required, but are only available for shipments to certain destinations. A distribution license will only be granted if the dealer will be distributing the goods pursuant to an agreement with the supplier which "[e]ffectively assures compliance with the U.S. Export Administration regulations, including the provisions set forth in [15 C.F.R.] § 373.3(1) [record-keeping requirements] and . . . [l]ists the country or countries in which the commodities are to be distributed." 15 C.F.R. § 373.3(c)(1)(ii) (1983). Therefore, if a supplier intends to apply for a distribution license it should consider including the following clauses in the appointment contract:

a. Dealer should agree to certify on Form ITA-6052 (Statement by Foreign Consignee in Support of Special License Application) that it will not sell to any person on the Department of Commerce's Denial List or to any person whom it believes will reexport to an unauthorized destination.

b. Dealer should agree to keep records for at least two years from the date of sale regarding the purchaser, the date of sale or reexport and the type, value and quantity of goods sold.

2. Other Record-Keeping Requirements
Apart from the case where a special distribution license is obtained, general record-keeping duties are required of all exporters by 15 C.F.R. § 387.13 (1983). It is therefore desirable to require the dealer to maintain appropriate books and records and to allow the supplier to have access to such books and records in order to allow the supplier to comply with its own record-keeping requirements.

E. **United States Foreign Corrupt Practices Act**
The Foreign Corrupt Practices Act (FCPA) makes it a criminal offense for any domestic person or firm to make payments directly or indirectly to foreign government officials or parties and thereby obtain or retain business. 15 U.S.C. §§ 78dd-1, 2 (1983). The penalty for violating the FCPA may be a $10,000 fine and five years' imprisonment for individuals (including corporate officers, directors and employees) and a fine of up to $1 million for corporations.

1. Types of Payments
   a. *Bribe versus "Grease" Payment*
   Under the FCPA, payments to influence decisions such as awarding a government contract are clearly illegal. Payments to expedite the performance of a ministerial duty required by statute, however, may be legal.
   b. *Commercial Bribes*
   Bribes purely in the commercial context are not prohibited by the FCPA; such bribes are usually regarded as civil violations under the local law, however, and could subject those involved to civil or criminal penalties.

2. Reason to Know Test
The FCPA prohibits corrupt payments to:
   a. any foreign official;
   b. any foreign political party or official thereof;
   c. any candidate for foreign political office; or
   d. *any other person* where the payor *knows or has reason to know* that part of the payment will be given or offered, directly or indirectly, to any of the above.

   Under subparagraph d, if the supplier has reason to know that its sales representative may pass on part of its commission to any of a through c above, the supplier has an affirmative duty of inquiry as to the agent's activities. If questions are not asked, the payor may be liable for the payments.

3. Circumstances Raising Duty of Inquiry
   a. *Distributor versus Sales Representative*
      Since distributors do not usually receive payments from the suppliers, the risk of FCPA violations is lower with this type of appointment. If the distributor requests a larger than usual discount in order for it to obtain a major sale, a duty to inquire might arise.
   b. *Size of Commission*
      If the commissions are substantially in excess of the going rate for work of the type the dealer performs, a duty to inquire might arise
   c. *Requests for Payment to Bank Account in Third Country*
   d. *Dealer's Relationship to Government Officials*
      If any close family, political or business ties exist with government officials, a duty to inquire might arise.
4. Anti-FCPA Violation Clauses
   a. Undertaking by the dealer that it will not make, offer or agree to offer anything of value to any government official, political party or candidate for government office.
   b. Undertaking by the dealer to comply with all U.S. laws and regulations including those regarding corrupt payments.
   c. Appending to the agreement any corporate code of conduct or policy guide regarding ethical standards.
   d. Representation that the dealer will not employ or be owned by government or political officials.
   e. Indemnification by dealer for supplier's losses due to FCPA violation of dealer.
5. Proposed Changes
   The Business Accounting and Foreign Trade Simplification Act, S. 414, 98th Cong., 1st Sess. (1983), currently pending in Congress, would amend the FCPA as follows:
   a. Replacement of the "reason to know standard" with liability only for direction or authorization to make payment.
   b. Clarification that certain payments that are customary in the country where made and "the purpose of which is to

expedite or to secure the performance of a routine governmental action" are legal as well as payments legal under the law of the foreign official's country or expenditures associated with the "demonstration or explanation of products."

F. **Tax Considerations**

1. Passage of Title

The location of passage of title of goods sold abroad will determine whether the exporter has domestic or foreign source income. It may be in the exporter's interest to transfer title to the products outside the United States and thereby generate foreign source income if, for example, other foreign operations of the exporter have generated an excess foreign tax credit for U.S. tax purposes. If foreign passage of title is agreed upon, care should be taken that passage of title occurs in the foreign port of entry but before customs clearance, so that customs duties and other indirect taxes are imposed on the purchaser.

2. Permanent Establishment Issues

The supplier's liability for tax in the foreign country will frequently be determined by whether the supplier is considered to have a "permanent establishment" in that jurisdiction. Although the details vary, United States double taxation treaties generally provide that a permanent establishment in the foreign country will exist if business activities are carried on through a dependent agent. Where there is no treaty, liability for foreign tax will generally depend upon the degree of the dealer's independence from the supplier and the dealer's inability to act on behalf of the supplier. It should therefore be made explicit in all appointment contracts that the dealer has no authority to make contracts or accept orders for products on behalf of the supplier.

3. DISCs and FSCs

a. *Background*

In the past it was possible for exporters to qualify a subsidiary corporation as a Domestic International Sales Corporation (DISC) in order to reduce substantially their federal income tax on export earnings. A DISC was not taxed at the corporate level. Instead, its shareholder (the parent or supplying company) is deemed to receive dividend distributions of half of the income generated by the DISC. Tax was deferred completely on the other part of the DISC income until the actual distribution of such earnings.

b. *Recent Developments*

United States export incentives such as DISC's have been under attack from GATT (General Agreement on Tariffs and Trade) members as illegal subsidies under GATT rules. As a result, as part of the Tax Reduction Act of 1984, legislation replacing the DISC with the Foreign Sales Corporation (FSC) was passed. Although the same type of export transactions would continue to qualify under the new legislation effective January 1, 1985, the FSC will be required to undertake certain activities outside the United States in order to obtain the benefit of permanent exemption of a portion of export sales income.

The FSC must be organized under the laws of a foreign jurisdiction and maintain an office outside the U.S. customs territory. The tax rules apply to export sales income if the "economic processes" of the transaction take place outside the United States. The foreign "economic processes" test will be satisfied "if . . . the [FSC] (or any person acting under a contract with such corporation) has participated outside the United States in the solicitation (other than advertising), the negotiation or the making of the contract relating to such transaction." Query whether an independent distributor could be the person acting under contract.

V. CONCLUSION

Although the appointment of a foreign dealer may at first glance appear to have few legal ramifications, the U.S. supplier appointing a foreign dealer is actually walking into a maze of applicable legislation containing costly traps for the unwary. An understanding of the applicable legislation and a little careful drafting can, however, go a long way toward protecting the supplier's interests.

APPENDIX

Listed below are countries that have special legislation providing *termination compensation* to dealers terminated by a supplier without just cause. The list does not include countries with statutes or judicially developed doctrines that only establish minimum termination notice requirements or formal registration requirements. It also does not take into account labor law provisions which in some countries protect individuals acting as dealers.

1. *Applicable Primarily to Distributors*

   Belgium. Law of July 27, 1961, on the Unilateral Termination of Indefinite Exclusive Distribution Agreements, Mon. Belge, Oct. 5, 1961, and Law of Apr. 13, 1971, Mon. Belge, Apr. 21, 1971. Applies to distributors only but courts have extended some protection to commission agents.

2. *Applicable Primarily to Agents or Sales Representatives*

   Austria. Mercantile Agents Law of 1921, as amended on June 15, 1978. Possibly applies to definite-term distributors also.

   Brazil. Law No. 4886 of Dec. 9, 1965.

   Finland. Law No. 389 of May 30, 1975.

   France. Decree No. 58-1345 of Dec. 23, 1958.

   West Germany. Commercial Code, arts. 84-92c.

   Italy. Civil Code, art. 1742.

   Netherlands. Commercial Code, art. 74a.

   Spain. Royal Decree 2033/1981, Official State Bulletin No. 209 (Sept. 12, 1981) *amended by* Royal Decree 1195/1982, published in the Official State Bulletin, June 14, 1982. Applies only to individuals, not to legal entities acting as agent.

   Sweden. Act of Apr. 18, 1914, *amended by* Law 219 of May 1974; Swedish Code, § 51.

   Switzerland. Law of Agency Agreements of Feb. 4, 1949, codified at Code of Obligations, art. 418a.

   Yugoslavia. Decree on the Representation of Foreign Firms in Yugoslavia in the Trade of Goods. Apr. 21, 1978, Official Gazette No. 20/78; amended Oct. 28, 1983, Official Gazette No. 56/83.

3. *All Dealers*

   Bahrain. Commercial Agencies Law, Amiri Decree No. 23 of Sept., 1975. Commercial Companies Law, Amiri Decree No. 28 of Nov., 1975.

   Colombia. Commercial Code, arts. 1317-1331. *But see* Cacharreria Mundial, S.A. v. Jorge Ivan Merizalde Soto, *et al.* (Supreme Ct. of Colombia, Dec. 2, 1980).

   Costa Rica. Law No. 6209 of Mar. 9, 1978.

   Dominican Republic. Law 173 of Apr. 6, 1966, *amended by* Law 263

of Dec. 31, 1971, Law 622 of Dec. 28, 1973 and Law 664 of Sept., 1977.
Ecuador. Law No. 1038-A of Dec. 18, 1976, published in the Official Register No. 245, Dec. 31, 1976.
El Salvador. Commercial Code, arts. 392-399B, *amended by* Decree Law No. 247 of Jan. 9, 1973, published in the Official Diary, No. 23, Feb. 3, 1973.
Guatemala. Decree No. 78-71 of Aug. 1, 1971, published in the Official Gazette of Oct. 1, 1971.
Honduras. Decree Law No. 549, Nov. 24, 1977, *amended by* Decree No. 804 of Sept. 10, 1979. The Regulations to Decree Law No. 549 are set forth in Resolution No. 669-79 of Nov. 16, 1979.
Indonesia. Ministry of Industry Decree No. 295/M/SK/7/1982, dated July 7, 1982.
Jordan. Law No. 20-74 of May 1, 1974, *amended by* Law No. 23-79, effective May 16, 1979.
Kuwait. Commercial Law, effective Feb. 25, 1981, arts. 281-282.
Lebanon. Decree No. 84 of 1967, *amended by* Decree No. 9639 of 1975.
Nicaragua. Decree No. 13 of Dec. 22, 1979 (reenacting and modifying Decree No. 287 of Feb. 2, 1972).
Norway. Law of June 30, 1916, *amended by* Law of June 1, 1973.
Oman. Royal Decree No. 26/77, Omani Official Gazette of Jan. 6, 1977.
Panama. Cabinet Decree No. 344 of Oct. 31, 1969; Executive Decrees No. 9 of Feb. 7, 1970, and No. 48 of Apr. 6, 1971.
Philippines. Presidential Decree No. 1789 ("Omnibus Investments Code"), art. 70. Applies only if the foreign supplier is "doing business" in the Philippines.
Puerto Rico. Act No. 75 of June 24, 1964, *amended by* Act No. 105 of June 23, 1966, and Act No. 17 of May 24, 1971. P.R. Laws Ann., tit. 101, §§ 278-278(d) (1975).
Saudi Arabia. Royal Decree M/11 of 1962, *amended by* Royal Decrees M/5 of 1969, M/8 of 1973 and M/32 of 1980; Ministerial Decision No. 1897, Official Gazette No. 2865 (Apr. 17, 1981). These laws relate to dealers in general; termination compensation is actually indicated only by administrative practice.
Thailand. Civil and Commercial Code, art. 827. Does not apply to agreements which expressly exclude termination compensation, assuming no "abuse of rights."
United Arab Emirates. Federal Act No. 18 of 1981, art. 9. (Note:

recent indications are that boycott certification will be required. Precautions should be taken prior to contacting any agents in Abu Dhabi or Dubai).

Virgin Islands. V.I. Code Ann., tit. 12A, § 130.

Yemen Arab Republic. Law No. 17 of 1972; Decree No. 6, of 1976.

Listed below are several countries that have special legislation that severely restricts the use or appointment of dealers by imposing formal registration requirements, often including administrative approval of the contents of the dealership agreement prior to appointment, or by limiting the functions of such dealers. This list is not absolute; it merely includes those countries where the laws regarding dealers appear particularly restrictive.

Algeria. Law No. 78-02 of 1978; Ministry of Commerce Circular No. 9 of Mar., 1982.

Burma. Since the passage of the "Nationalization of Enterprises Law" in 1962, only a government entity (the "Inspection and Agency Corporation") may act as dealer.

Egypt. Law No. 107 of 1961, Law No. 93 of 1974, Presidential Decree No. 1906 of 1974, Law No. 117 of 1975, Presidential Decree No. 14 of 1976, Law No. 120 of 1982 (effective Apr. 27, 1983).

Iraq. Law 208 of 1969, Law No. 8 of 1976; Regulation No. 1 of 1976.

South Korea. Art. 24 of the Anti-Monopoly and Fair Trade Law (effective Apr. 1, 1981), Art. 28 of the implementing Enforcement Decree and Economic Planning Board Notice No. 49 (requires registration of dealership contracts which may endure longer than one year).

Libya. Decree No. 40 of 1971 and Resolution No. 73 of 1975 mandate the use of a public sector agent in practically all import transactions. (Note: Unconfirmed report that agencies, as described in Decree No. 40, are no longer permitted).

Qatar. Law No. 12 of 1964.

Syria. Legislative Decree No. 51, Sept. 30, 1979; Prime Minister Notification No. 14/B 271/15 of Feb. 7, 1980.

Trinidad & Tobago. Act No. 41 of 1980 ("Foreign Enterprises Act").